

**ENDOWMENT FUND INVESTMENT BOARD
FINAL MINUTES OF THE REGULAR MEETING**

August 21, 2003

Members Present:

M. Dean Buffington
Representative William W. Deal
Gavin Gee
Senator Brad Little
Dr. Rick Miller
William D. Mitchell
John Taylor
Parker G. Woodall (via telephone)
Tom Kealey

Staff Present:

Matt Haertzen, Investment Manager
Connie Eshelman
Andrew Potter
Mary Livengood

Deputy Attorney Generals

David High
A. Renee Martin
Julie Weaver

Milberg Weiss Bershad Hynes & Leroch

Kenneth Addison Duncan

Guests:

RBC Dain Rauscher

Brian Hayes
John Bullman

PERSI

Richelle Sugiyama
Bob Maynard

Legislative Services Office

Ray Houston

Division of Financial Management

Larry Schlicht

State Treasurer's Office

Shawn Nydegger

Deloitte & Touche, LLP

Lou Henry

Marvin & Palmer

Tim McAvoy
Todd Marvin

Chairman Dean Buffington called the meeting to order at 7:34 AM and recognized that a quorum was present.

APPROVAL OF MINUTES

Motion by Representative Deal, second by Mr. Mitchell to approve the minutes of the May 21, 2003, regular meeting as presented. The motion carried unanimously.

CAPITOL PERMANENT FUND REPORT – Mr. Haertzen

Mr. Haertzen gave a brief update of the Capitol Permanent Fund performance. He noted it would be more cost effective and improve the portfolio diversification to have the Capitol Permanent Fund placed into the “Pooled Fund” for investment purposes. Their Board is considering this recommendation, and if approved will work on legislation to allow this change.

STATE INSURANCE FUND REPORT

Mr. Haertzen reported that Mr. Dorn is no longer the consultant for the State Insurance Fund. The State Insurance Fund has hired RBC Dain Rauscher as their consultant. Since the State

Insurance Fund assets cannot be commingled with other funds, Northern Trust is investing all fixed income assets in a separately managed fixed index account. All mutual funds have been converted to an index fund to minimize costs. Mr. Haertzen is working with the State Insurance Fund to further diversify the equity portion of the portfolio. Most of the Endowment Fund managers are being used in the State Insurance Fund to provide this further equity diversification. Representative Deal noted that Mr. Alcorn is pleased with the good service Mr. Haertzen has delivered to the State Insurance Fund.

JUDGES RETIREMENT SYSTEM REPORT

Mr. Haertzen met with a Judges Committee. The committee recommended replacing Tom Johnson Investments as their equity manager and use a number of the Endowment Fund managers to provide added diversification. RBC Dain Rauscher has made a proposal to be the Judges consultant. At present, Bill Reese provides consulting and accounting services to the Fund.

ENDOWMENT FUND INVESTMENT BOARD REPORT

Marvin & Palmer representatives were not scheduled to make their presentation until 8:00 AM. By general consensus the board moved to Agenda Item D.

Investment Policy Statement

Some wording changes were suggested at yesterday's Roundtable Meeting. Mr. Haertzen presented an updated version of the Investment Policy Statement. Motion by Mr. Woodall second by Mr. Gee, to approve the Investment Policy Statement with those changes. The motion carried unanimously.

FY 2005 Budget

The budget to be submitted for fiscal year 2005 is less than last year. One staff position was eliminated and approximately \$10,000.00 in operating expenses was eliminated for next year. Substantial electronic upgrades were made during the last fiscal year so the capital budget can be reduced to a more normal level. Motion by Representative Deal, second by Mr. Gee to adopt the budget as presented. Mr. Haertzen noted there have been significant savings on the continuous appropriation with equity manager fee reductions and consultant fee savings. The motion carried unanimously.

Comparative Universe Data – Brian Hayes

Mr. Hayes presented the public fund comparisons with other state investment organizations as of March 31, 2003. The report will always be a quarter behind in order to compile the necessary data from other funds. Mr. Hayes explained the charts and comparisons. Senator Little requested returns for 3, 5, and 10 years for comparison. Mr. Haertzen noted the Governor requested this report. It will be prepared quarterly in the future.

Marvin & Palmer Presentation – Tim McAvoy and Todd Marvin

Marvin and Palmer is an international fund manager. Their inception date with the Endowment Fund Investment board was July 1, 2003, so they have only been working with our fund for seven weeks. The initial funding went smoothly.

Mr. McAvoy gave the following overview of the company. Marvin & Palmer is an independently owned firm located in Wilmington, Delaware. There are 60 employees; 33 of those employees are owners in the firm. No key investment professionals have left the firm in the last five years. The non-US portfolio is their primary product.

Mr. Marvin explained how the firm has invested EFIB funds. Marvin & Palmer is anticipating stronger markets going forward. Mr. Marvin expects strong growth from China where roughly 5% of Marvin and Palmer funds are currently invested. Marvin & Palmer also expect technology to experience a cyclical growth period internationally.

RBC Dain Rauscher – Brian Hayes

The equity markets are beginning to show some gains. Mr. Hayes discussed the managers, their style, and their weighting in the portfolio. Next quarter's report will show rebalancing ranges as well. Lazard was overweighted versus Marvin & Palmer at the end of June, but funds were withdrawn from Lazard for the public school distribution in July. The two international managers are more evenly balanced at this point. Metropolitan West and Nicholas|Applegate are on manager watch. Nicholas|Applegate has had significant personnel changes, while Metropolitan West has struggled with individual stock selection. Lazard is also causing concern because of their high turnover of analysts. Lazard currently has 34 analysts including 15 new in the last year, and a loss of 7.

Break 8:50-9:00 AM.

Dr. Rick Miller arrived during the break.

Preliminary Audit Report – Lou Henry

Mr. Henry explained the audit findings. Mr. Henry noted that the management change made things easier because of Mr. Haertzen's understanding of accounting. One continuing problem is the need to convert from cash basis to accrual basis once a year. The interface between the Department of Lands and the Endowment Fund Investment Board was better this year, with the accrual versus cash basis creating the most problems. Mr. Henry recommends that a better reconciliation process be instituted to work out the problems of year-end cutoff among the Treasurer, Controller, Department of Lands, and the Endowment Fund Investment Board. Mr. Henry noted that Mr. Potter's reconciliation was accurate in every area.

A correction was made to the 2001 Audit to adjust the allocations of gains and losses from a monthly to annual basis as required by statute. This issue was corrected between the fiscal year 2002 and fiscal year 2003 audits.

There was one reportable condition pertaining to oversight of the monthly accounting process. Mr. Haertzen has agreed to review all journal entries on a monthly basis to catch any possible errors or omissions. Mr. Henry concluded by reviewed the past year's recommendations.

Capitol Permanent Audit

This audit went very smoothly. The recommendations were consistent with those pertaining to the Endowment Funds.

Mr. Henry stated he has enjoyed the relationship for the last 8 years and that Deloitte & Touche will submit a proposal for the new audit contract.

Audit Committee – Mr. Woodall Chairman

The Audit Committee will work with Mr. Haertzen and staff and a sub-committee will review the Audit RFP responses.

Gavin Gee Disclosures – Mr. Gee

Mr. Gee referred the board to his written disclosures and an Attorney General Opinion included in the board packet. The Attorney General opinion stated there did not appear to be a conflict of interest with Mr. Gee's spouse working for Balukoff Lindstrom & Co., a possible bidder on the Audit RFP. However, he suggested that Mr. Gee disclose that fact to the board. Mr. Gee's wife is a tax manager and has no participation in the audit area. She is considered "part time" other than during tax season. She participates in a profit sharing program based upon her salary. Former Board Chairman Dr. Hallett has a son who also works for the same firm. Dr. Hallett's position on the board created a possible conflict because his son is a partner in the audit group. This may have contributed to Dr. Hallett's resignation from the board. Once the disclosure was made, Mr. Gee absented himself from the audit RFP discussion. Mr. Buffington noted that Mr. Gee will resign if the Board feels it is necessary. Board members expressed their feeling that Mr. Gee should not resign.

Audit RFP

Motion by Representative Deal, second by Mr. Taylor to add the firms of Moss Adams of Portland, Oregon, and BDO Seidman of either Portland or Seattle, Washington, to the audit RFP contact list. The motion carried unanimously. Motion by Representative Deal, second by Mr. Taylor to approve the Audit RFP format; to request the Division of Purchasing to send the RFP to those firms on the list; and to make the RFP available to any other interested auditing firms. The motion carried unanimously.

Web Site

Mr. Haertzen gave a brief demonstration of the EFIB web site that will be available to the public sometime in September. The board agendas and minutes, board packets, and performance reports will be available on-line when the site is completed and will be available to anyone who accesses the site. The audit and the RBC Dain Rauscher quarterly reports will also be available. When the site is open, Mr. Haertzen will send board members a link to the board packet on-line instead of sending the packets via e-mail as he is currently doing.

Audit Committee, Bond Committee, Search Committees

Since bonds are no longer managed in-house, the Bond Committee is no longer necessary. The Search Committee has completed their work. The Audit Committee is the only committee with work to complete. Motion by Mr. Woodall, second by Mr. Gee to retain the Audit Committee and to disband the Bond and the Search Committees. The motion carried unanimously.

Calculation of Gain/(Loss)

Mr. Potter is working with Larry Schlicht of DFM and Ray Houston of Legislative Services to address the allocation issues arising from the current method of calculation.

Discussion from the Roundtable Meeting

Custodian RFP – Motion by Representative Deal, second by Mr. Parker to instruct the Manager of Investments to prepare a Request for Proposal for a new Custodian. The motion carried unanimously.

QInsight as Consultant – There is no contract and QInsight can be used as needed.

Alternative Asset Classes – No additional work will be done on this item at this time.

Updated Timber Revenues – Mr. Wiggins of the Department of Lands projected lower timber revenues for the next several years. Mr. Haertzen will update the Board of Land Commissioners in September on that report and how it will affect the distributions to the Public School and Pooled funds.

Staff Reports – as included

Motion by Mr. Gee, second by Mr. Mitchell to enter into executive session to discuss possible legal and/or personnel issues. The roll call vote was as follows:

Mr. Buffington	Aye	Dr. Miller	Aye
Mr. Gee	Aye	Mr. Mitchell	Aye
Rep Deal	Aye	Mr. Taylor	Aye
Mr. Kealey	Aye	Mr. Woodall	Aye
Senator Little	Aye		

The motion carried unanimously.

Reconvene Regular Session at 11:15 AM

Class Action Litigation

Mr. Maynard discussed the class action lawsuit that has been filed against WorldCom's former executives and their underwriters. Mr. Maynard stated that it is generally PERSI's policy not to be a lead plaintiff. Motion by Mr. Gee, second by Mr. Kealey that, based on discussion with the attorneys, the Endowment Fund Investment Board join with the State Treasurer in their lawsuit against WorldCom's former executives and their underwriters. The motion carried unanimously. Mr. Taylor stated that due to a personal interest, he abstained from voting.

Legislation – DAG Julie Weaver

At present, the Public School Endowment Fund and the Pooled Endowment Fund are held in separate accounts. To reduce investment costs and improve efficiencies, it would be more effective to have only one account. Ms. Weaver suggested introducing legislation to clarify *Idaho Code, Section 57-720* to allow both funds to be invested as one unit and to change the word "regulations" to "policies." Motion by Representative Deal, second by Mr. Taylor to accept the recommended legislation changes. The motion carried unanimously.

November Meeting Date

Mr. Haertzen noted that the Board of Land Commissioners has requested a review of the audit in a Joint Land Board/Endowment Fund Investment Board meeting. He would like to set this audit

review meeting during the November Board of Land Commissioners meeting. Since the November Land Board meeting falls on a State holiday (Veterans' Day), the November meeting date is not yet set. By general consensus the board agreed to set the Endowment Fund Investment Board regular November meeting following the joint November meeting with the Board of Land Commissioners.

There being no further business, the meeting was adjourned at 11:35 AM.

- MOTION: That the minutes of the May 21, 2003, regular board meeting be approved as presented.
- MOTION: That the new Investment Policy Statement be approved as presented.
- MOTION: That the FY 2005 Budget be adopted as presented.
- MOTION: That the firms of Moss Adams and BDO Seidman be added to the Audit RFP contact list.
- MOTION: That the format of the Audit Request for Proposal be approved and that the Division of Purchasing be requested to send the RFP to those firms on the contact list as well as make it available to all other interested auditing firms.
- MOTION: That the Bond Committee and Search Committee be disbanded and the Audit Committee be retained.
- MOTION: That the Manager of Investments prepare a Request for Proposal for a new Custodian contract.
- MOTION: That the board enter into Executive Session to discuss potential legal issues and personnel issues.
- MOTION: That the Endowment Fund Investment Board join the State Treasurer in a lawsuit against WorldCom's former executives and their underwriters.
- MOTION: To accept the Deputy Attorney General's recommendation to introduce legislation to allow commingling the Public School endowment fund with the Pooled endowment fund for investment purposes and to change the word "regulations" to "policies" in *Idaho Code*, Section 57-720.